

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Barbara Beerhalter	Chair
Cynthia A. Kitlinski	Commissioner
Norma McKanna	Commissioner
Robert J. O'Keefe	Commissioner
Darrel L. Peterson	Commissioner

In the Matter of the Petition ISSUE DATE: May 23, 1988
of AT&T Communications of the
Midwest, Inc., to Change Its DOCKET NO. P-442/EM-87-862
Rates for Telephone Service
Offered Within the State of FINDINGS OF FACT AND Minnesota
CONCLUSIONS OF LAW AND
ORDER

PROCEDURAL HISTORY

On December 31, 1987, AT&T Communications of the Midwest, Inc. (AT&T or Company) filed with the Minnesota Public Utilities Commission (Commission) revised tariff pages, price lists, and cost study information pursuant to Minn. Stat. Sec. 237.60, Subd. 2 (Supp. 1987). In that filing, the Company proposed to discontinue the Community Calling and Circle Calling Rate Break toll discount plans on February 1, 1988. At the request of Commission staff, AT&T delayed the effective date for the proposed discontinuance of the toll discount plans until March 1, 1988.

On January 6, 1988, the Commission issued a Notice of Comment Period and Commission meeting. The notice stated that the matter would be heard by the Commission as an expedited proceeding under Minn. Stat. Sec. 237.61 (Supp. 1987).

On January 22, 1988, the Residential Utilities Division of the Office of the Attorney General (OAG), the Minnesota Business Utility Users Council (MBUUC), and the Department of Public Service (DPS) filed initial comments on AT&T's rate change filing.

On January 25, 1988, the Department of Administration (DOA) filed initial comments on AT&T's rate change filing.

On February 1, 1988, AT&T's proposed rates went into effect in accordance with Minn. Stat. Sec. 237.60, subd 2(b).

On February 2, 1988, the OAG and the DPS filed separate reply comments disagreeing with AT&T's rate design recommendation.

On February 3, 1988, AT&T submitted reply comments in response to the initial comments of the

DPS, OAG, and the DOA.

In a letter dated February 12, 1988, AT&T informed the Commission of its intention to flow through the reduction in the Carrier Common Line Charge (CCLC) it pays Northwestern Bell Telephone Company (NWB) resulting from the settlement in Docket No. P-421/CI-86-354 (the "DOD" settlement).

On February 16, 1988, the Commission met to consider AT&T's petition. The Commission heard oral comments from AT&T, the DPS, the OAG, the DOA, and the MBUUC. The Commission determined that additional information was necessary and that it would wait 60 days before taking final action on AT&T's petition. The Commission also determined that AT&T's toll discount plans should remain in effect until additional information had been gathered. On February 23, 1988, the Commission issued an order staying elimination of the toll discount plans until May 1, 1988.

On April 15, 1988, Runestone Telephone Association (Runestone) submitted a letter, commenting on AT&T's MTS rate increases and proposed cancellation of toll discount plans. Other letters regarding these services from AT&T ratepayers were also received during April.

On April 25, 1988, the Commission held a second meeting to consider AT&T's petition after gathering additional information. The Commission heard oral comments from AT&T, the DPS, the OAG, the DOA, the MBUUC, and Runestone.

SUMMARY OF AT&T PROPOSAL

AT&T initially proposed to increase its overall revenues by approximately \$11.9 million and to restructure rates for Message Telecommunications Service (MTS), and Wide Area Telecommunications (WATS) effective February 1, 1988, pursuant to Minn. Stat. Sec. 237.60, Subd. 2. AT&T's initial proposal increased MTS rates by 6%, Full Time Outward WATS by 46%, and Full Time 800 Service by 9%. AT&T explained that the proposed rate changes were intended to more closely reflect the cost of providing those services. AT&T also proposed to discontinue the Community Calling Plan and the Circle Calling Rate Break Plan effective February 1, 1988. At the request of the Commission staff, AT&T delayed the proposed effective date for the discontinuation of service under these plans until March 1, 1988. AT&T also proposed several miscellaneous rate changes and the elimination of legal holiday toll discounts.

In a letter dated February 12, 1988, AT&T offered to revise its proposed rates to reflect the reduction in the Carrier Common Line Charge (CCLC) it pays NWB resulting from the settlement in Docket No. P-421/CI-86-354. AT&T estimated that the effect of the reduced CCLC would be to reduce its proposed revenue increase from \$11.9 million to \$7.4 million, i.e., by approximately \$4.5 million dollars. Under this revised revenue requirement, MTS rates would increase by 3.5%, Full Time Outward WATS by 38%, and Full Time 800 Service by 7%. In conjunction with the revenue decrease to reflect a reduced CCLC, revenues will also decrease to reflect reduced gross receipts tax liability.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Jurisdiction

AT&T has filed with the Commission a notice of its election to be subject to Minn. Stat. Sects. 237.58 through 237.60 and 237.62 (Supp. 1987). (See Docket No. P-442/EM/87-494). These laws alter the rate change process for companies who elect to be covered by them and whose services are subject to emerging competition. Minn. Stat. Sec. 237.59, subd. 1 (Supp. 1987), lists services the Legislature has found to be subject to emerging competition. This list includes all services offered by AT&T.

Minn. Stat. Sec. 237.60, subd. 2(a) (Supp. 1987) provides that the telephone company must file a price list containing the rates, tolls, and charges for the emerging competitive service along with the rules, regulations, and classifications used in providing that service. AT&T did so in its December 31, 1987 filing. AT&T also included a cost study to support its proposed rate increase as required by Minn. Stat. Sec. 237.60, subd. 2(b) (Supp. 1987).

The statute provides that a company may increase the rate for a service subject to emerging competition effective 30 days after notice to affected customers, the Commission and the DPS. The Company implemented its initially proposed rate increases for MTS and WATS on February 1, 1988. The statute also provides that the Commission may adjust rates after an expedited proceeding and may order the Company to make any necessary refunds to affected customers. Minn. Stat. Sec. 237.61 (Supp. 1987)

On January 6, 1988, the Commission informed parties that this matter would be addressed as an expedited proceeding unless there were material facts in dispute. No material fact issues were raised by the parties; no party requested contested case proceedings. Therefore, the matter has been addressed in an expedited process under Minn. Stat. Sec. 237.60, subd. 2(b) and 237.61 (Supp. 1987).

Form of Regulation and Standard for Review

Minn. Stat. Sec. 237.60, Subd. 2, charges the Commission with the duty of determining whether proposed rate increases for emerging competitive services are excessive. The Commission believes that it must interpret this legislative directive in terms of its broad and long-standing responsibility under Minn. Stat.

Sec. 237.06 (1986) to insure that the rates charged for telephone services are fair and reasonable. Minn. Stat. Sec. 237.06 has not been replaced as the basic standard for rates to be charged consumers.

Webster's defines "excessive" as "exceeding the usual, proper, or normal [syn. immoderate, inordinate, extravagant, exorbitant, extreme]. The Commission finds that "excessive" may be equated with "unreasonable" when referring to rate level. The Commission does not interpret this language as establishing degrees of reasonableness, culminating at some definable threshold of "excessive" which, when it is reached, will allow the Commission to intervene to protect ratepayers. The Commission concludes that the Legislature has restated the fair and reasonable standard of review. The Commission believes that the legislative intent was to reduce the level of regulation for emerging competitive services but at the same time give the Commission enough flexibility in setting rates for these services to enable it to provide for fair and reasonable rates for Minnesota ratepayers

AT&T's Cost Study

AT&T's MTS, WATS, and 800 services have been determined to be subject to emerging competition. Therefore, in accordance with Minn. Stat Sec. 237.60, AT&T filed supporting cost study information along with the price increases for these services. AT&T must demonstrate that its prices for services, subject to emerging competition, are reasonable. Cost is an important factor to consider when evaluating the reasonableness of rates.

AT&T's cost study information included descriptions of the types of costs, supporting calculations, and references to sources of data used to calculate costs. AT&T categorizes its costs as access and non-access costs. According to AT&T, access costs reflect the tariffs of local exchange carriers. AT&T uses NWB's State Access Tariffs as a proxy for access costs in the State of Minnesota. Non-access costs include all other costs for the use of facilities and equipment.

The DPS investigated AT&T's cost study. According to the DPS, access costs are the major portion of AT&T's total incremental costs. The DPS verified AT&T's access costs by comparing them to NWB's access tariffs. The DPS also reviewed the non-access costs of AT&T's cost study. According to the DPS, AT&T's non-access costs are computed using a computer model. This model calculates the costs of land, buildings, and equipment needed to provide message and toll service. The DPS explained that non-access costs are a small portion of total costs. Based on its review, the DPS believes AT&T's cost study is accurate and recommended approval.

The MBUUC and the DOA opposed acceptance of AT&T's cost study. MBUUC stated that the rate increase for Outward WATS should be considered unreasonable and recommended further analysis of the cost study before relying on it to set rates. DOA claimed that AT&T's cost study could not be relied upon to set reasonable rates because monthly usage information had not been supplied.

Since WATS and 800 services have a fixed monthly rate component, monthly usage information is necessary to determine the costs associated with those services. The DPS then obtained the monthly usage information. AT&T also provided the monthly usage information to DOA and other parties upon request.

DOA also claimed that the prices should be deemed unreasonable because they were significantly above cost. AT&T responded that the price for Full Time WATS must cover incremental costs plus contribute to joint and common costs of AT&T. The DPS and OAG agreed with AT&T.

The Commission finds that AT&T's cost study data is appropriate for setting rates in this proceeding. The MBUUC and DOA did not challenge the accuracy of the cost study. The DOA's argument of insufficient information has been satisfied by the provision of monthly usage information. DPS reviewed the cost study and found it adequate. The Commission will accept it for this proceeding.

Message Telecommunications Service

AT&T's initial proposal was to increase MTS rates by 6%. This proposal was later reduced to 3.5% to reflect the "DOD" settlement. AT&T also proposed that its MTS rates be restructured, with a reduction in the number of mileage bands from 19 to 8, a larger rate increase for short haul mileage bands than long haul bands, and a reduction in the Evening and Night/Weekend discounts (from 32% to 25% for Evening calls and from 50% to 45% for Night/Weekend calls).

AT&T stated that its proposal regarding mileage bands, i.e., as to their rate structure and number, is appropriate because costs for MTS do not vary significantly with length of haul. According to AT&T, Minnesota law and economic efficiency require that all rates, i.e., each mileage band, must cover incremental cost. AT&T argued that its existing rate design must be changed to reduce the subsidization of short haul toll and to promote competition.

The OAG recommended retaining the existing 19 mileage bands and implementing rate changes uniformly across all mileage bands. The OAG stated that rate design for MTS should be deferred until the results of the "582 Docket" (P-999/CI-85-582) and the "354 Docket" (P-421/CI-86-354) were known so the financial impact on AT&T could be calculated. According to the OAG, implementing MTS rate design changes after these two dockets have been completed would moderate the increase to short haul rates. The OAG also opposed the proposed rate design on grounds that it would tend to burden those ratepayers most subject to monopolistic or quasi-monopolistic conditions. OAG also denied that each of AT&T's rates must cover marginal costs to comply with Minnesota law.

The DPS recommended reducing the number of mileage bands to 9 (instead of 8) and increasing MTS rates by a smaller amount than AT&T's proposal for the two shortest mileage bands. The DPS recommended that any revenue shortfall resulting from the lower short haul rates incorporated in its proposal be recovered through higher long haul rates. The DPS stated that AT&T's proposed rate design changes for MTS would enhance competition and bring MTS rates more in line with cost as it is defined in AT&T's cost study. Further, the DPS stated that a revision of MTS rate design must involve an increase for short haul mileage bands. Finally, the DPS stated that its proposal, unlike that of the OAG, would allow the immediate pass-through of any reductions in access charges arising out of the "582 Docket" or the "354 Docket."

AT&T and the DPS subsequently compromised on their proposals. They agreed to jointly propose reducing the number of mileage bands to 9 and to lower the increases in the short haul mileage bands to the level proposed by the DPS.

The Commission must decide two issues with respect to AT&T's MTS rates:

1. Should rates cover incremental costs on an aggregate basis or on a mileage band basis?
2. What is an appropriate rate design for AT&T's Message Telecommunications Service?

The Commission finds that Minnesota Statutes do not specify whether costs for MTS must be recovered on an aggregate basis or on a rate element-by-rate element basis. Minn. Stat. Sec. 237.60, subd. 4 requires that rates "charged for competitive services must cover the incremental costs of the service." [Emphasis added] Minn. Stat. Sec. 237.57, subd. 2 defines "competitive service" as "a service that has been determined to be subject to effective competition or emerging competition." Minn. Stat. Sec. 237.59 identifies 23 services as subject to emerging competition. Included in this list are inter-LATA and intra-LATA message toll services.

Subdivision 4 of Minn. Stat. Sec. 237.60 allows telephone companies providing both local and long-distance services to recover contribution to common and joint costs on an aggregate basis as opposed to a time or mileage band basis. The Commission does not believe that the Legislature intended to establish separate standards for long-distance companies and companies providing both local and long-distance services, especially since aggregate recovery could create pricing advantages over uniform recovery.

Therefore, the Commission finds that Minnesota Statutes give the Commission discretion to determine the appropriate relationship between the rates and incremental costs for MTS.

AT&T's cost study shows that access charges represent the major portion of AT&T's total costs. Access charges currently are in the form of a flat charge per minute of use. In other words, access charges currently are not distance sensitive. Therefore, the costs of MTS long haul toll calling do not currently vary significantly from the costs of short haul toll calling.

AT&T's initial MTS rate design proposal would have ensured that rates for each mileage band covered incremental costs for that band. This proposal resulted in significantly larger rate increases for the short haul mileage bands than for the longer haul bands. The AT&T/DPS joint proposal leaves intact AT&T's initial rate proposals for the new medium and longer haul mileage bands, but reduces the rate increase for the shortest new mileage bands. Nevertheless, the rates for the shortest mileage bands would still increase four times as much as the rates for the longer mileage bands.

The Commission generally believes that utility rates should reflect underlying costs of service. However, the Commission also believes that non-cost factors, e.g., rate impact and ability to pay, have an important role to play in determining rate structures. [St. Paul Area Chamber of Commerce v. Minnesota Public Service Commission, 312 Minn. 250, 251 N.W. 2d 350 (1977)]

In that regard, the Commission shares the concern of the OAG, the DPS, and Runestone about the impact of MTS rate restructuring on short haul toll callers.

Furthermore, the short haul bands are the bands subject to the least competition and the ones most likely to be carrying traffic resembling local traffic, e.g., calls to schools in multi-exchange school districts, calls to and from places of employment, calls to hospitals and health care providers in neighboring communities. The social value of this traffic requires that the Commission examine large increases in these mileage bands with special care.

The Commission recognizes that the nature of AT&T's current cost structure may justify a movement toward fewer mileage bands and flatter rates across mileage bands. However, the Commission believes that any movement in that direction must occur with moderation to avoid unreasonably large rate increases. Also, it cannot occur without recognition and consideration of its social consequences.

For these reasons, the Commission finds that AT&T's proposal to recover costs on a mileage band basis would result in excessively high rate increases for short haul toll callers. Therefore, AT&T's MTS rates should be structured so that incremental costs are recovered on an aggregate basis.

The Commission finds that the AT&T/DPS compromise proposal for MTS rate design is reasonable except for the three shortest mileage bands. Consequently, for the mileage bands between 1 mile and 55 miles the Commission will adopt the methodology recommended by the OAG and substitute a uniform increase. This approach has the advantage of moderating the rate increase to the shortest mileage bands while allowing AT&T to implement rate design changes it claims it needs to be competitive. Under this approach, the proposed mileage bands producing the largest amount of revenue, i.e., 56 miles through 196 miles, would be subject to the rate design proposed by AT&T.

Incorporated in AT&T's recommended MTS rate design is a proposal to change the rates for its Evening and Night/Weekend discounts; from 32% to 25% for the Evening period and from 50% to 45% for the Night/Weekend period. The DPS found this change to be reasonable.

As noted above, the OAG opposed AT&T's MTS rate design proposal primarily on the grounds that it would be most burdensome for those customers most subject to monopolistic conditions or quasi-monopolistic conditions. The OAG claimed the proposed Evening and Night/Weekend discount reductions would exacerbate this result. The OAG stated that the market for residential services tends to be less competitive than the market for business services and that residential customers make a higher percentage of their toll calls during discount periods than business customers.

This proposal can be assessed by reviewing the underlying cost of the service and the impact the proposed change as part of the overall MTS rate design would have on ratepayers. AT&T's network is designed to handle peak loads which occur during the day. The additional network costs of calls placed during off peak times are negligible. However, as already noted, AT&T's primary cost item is access charges which are based on minutes of use and do not take into account the time of day. Consequently, AT&T's proposal to reduce the rate differentials between time periods appears to be justified by AT&T's current cost structure.

As to the impact of the rate change, the Commission believes that the discount reductions proposed by AT&T would not be unreasonably burdensome to ratepayers, considering the context of the MTS rate design adopted above. Therefore, the Commission finds that AT&T's proposed rate reductions for the Evening and Night/Weekend discounts are reasonable.

WATS

AT&T originally filed revised tariff pages to reflect an overall price increase for Full Time WATS of approximately 46% and for Full Time 800 service of approximately 9%. AT&T subsequently agreed to lower its proposed rates to reflect the lower access costs resulting from the recent Commission decision in the "DOD" settlement. AT&T's proposed price increases for Full Time WATS and Full Time 800 service were lowered to 38.3% and 7.1% respectively.

According to AT&T, the proposed rate increases were intended to align the prices to reflect their underlying cost structure. For services where a fixed rate is charged to customers, as is the case with Full Time WATS and 800, a change in average usage will cause a misalignment of cost and revenue. AT&T argued that costs had increased for Full Time WATS because average usage had increased. Therefore, AT&T argues that its proposed revenue increase is appropriate.

DOA opposed the rate increases for both Full Time WATS and Full Time 800 Service. DOA argued that the rate increases should be disallowed because the cost study information was inadequate. MBUUC opposed the rate increase for Full Time WATS until further analysis of the cost study had been made. DPS and OAG recommended approval of the rate increases for WATS and 800 service. As discussed previously, the Commission finds the cost study information appropriate for use in setting rates in this proceeding. Further, the Commission believes the competitive market environment provides some assurance that rates for WATS and 800 service will not be excessive. Nearly all customers will be able to find an alternative provider if they believe the service is not competitively priced. Therefore, the Commission will approve the proposed rates for Full Time WATS and 800 services.

Miscellaneous Rate Changes

AT&T proposed to restructure the tariff for operator handled conference service by establishing time of day discounts for the first minute of an operator assisted call. Currently, the time of day discount only applies to the additional minutes of a call. AT&T also proposed to establish a new network remote access feature to software defined network service. Finally, AT&T proposed to make certain wording changes to the calling card service tariff.

The DPS supported these proposals. No party opposed the three proposals.

The Commission finds that the proposed changes are reasonable. Therefore, the Commission will approve AT&T's proposals for these services.

Elimination of Legal Holiday Toll Discounts

AT&T proposed to eliminate the toll discount which currently applies to the day time period of the legal holiday, Monday or Friday, when the holidays of January 1, July 4, or December 25 fall on a Saturday or Sunday.

No party opposed the proposal to eliminate the legal holiday discount.

The Commission finds that the proposal to eliminate the legal holiday discount is reasonable. Therefore, the Commission will approve AT&T's request.

Access Charge Pass Through

The DOA, the DPS and the OAG raised the issue of access charge pass through. Their concerns focused on expected access charge reductions resulting from Docket No. P-999/CI-85-582 and how those reductions should be passed through to long distance ratepayers. All parties contemplated a pass through. AT&T asked to assess its financial situation before changing rates to reflect adjustments in access charges.

Because of AT&T's leadership position in the long-distance market and the prominence of access charges in AT&T's cost structure, the Commission finds that it is important that the access charge adjustments arising out of the "582 Docket" should be reflected in AT&T's rates as soon as possible.

AT&T's rates reflect a revenue requirement for its gross receipts tax. In its first filing under Minn. Stat. Sec. 237.60 (Docket No. P-442/EM-87-494), demonstrated that any change in revenues results in a direct change in its gross receipts tax liability. The Commission finds that it is appropriate to incorporate the revenue requirement for gross receipts tax when either a change or a proposed change in revenues is made. Therefore, the Commission will require that AT&T shall submit a filing reflecting the rate adjustments resulting from Docket No. P-999/CI-85-582, including the gross receipts tax, within 30 days of the new access charges becoming effective.

Refund

AT&T's proposed rates went into effect February 1, 1988 in accordance with Minn. Stat. Sec. 237.60, subd. 2(b). On February 12, 1988 AT&T submitted a letter to the Commission in which it offered to flow through the reduction in the CCLC resulting from the "DOD" settlement. The effect of the "DOD" settlement on AT&T's annual revenue requirement is approximately \$4.5 million excluding the gross receipts tax. That offer has been adopted by the Commission and incorporated in the findings in this case. Because the rates AT&T put into effect on February 1, 1988 did not reflect the pass through of the "DOD" settlement and related gross receipts tax, AT&T has been overcollecting revenues in the interim.

Minn. Stat. Sec. 237.60, subd. 2 (b) empowers the Commission to "order price adjustments

retroactive to the date the change went into effect and order the company to make any necessary refunds to affected customers."

The Commission finds that a refund is necessary to compensate customers for the difference between the rates implemented on February 1, 1988 and the rates approved herein. Consequently, the Commission will require that the refund be made on a mileage band basis in proportion to the rate increases implemented on February 1, 1988.

ORDER

1. AT&T's proposed cost study is approved for purposes of this proceeding.
2. The AT&T/DPS proposal to increase MTS rates is approved except that the three shortest distance mileage bands shall be increased by a uniform percentage.
3. The AT&T proposal to increase WATS rates is approved.
4. AT&T's proposed rate changes relating to operator handled conference service, software defined network service, and calling card service are approved.
5. AT&T's proposal to eliminate legal holiday MTS discounts is approved.
6. AT&T shall incorporate the effects of its gross receipts tax liability in its rate changes as approved in paragraphs 2,3,4, and 5. AT&T shall file schedules that calculate the effect of the gross receipts tax on revenues for each service.
7. AT&T shall submit for Commission review and approval revised tariffs or price lists reflecting the rate changes approved in paragraphs 2, 3, 4, 5, and 6 within 30 days of the date of this order and shall serve copies on all parties.
8. AT&T shall submit a proposed plan to refund the difference between rates implemented on February 1, 1988 and the rates approved herein to the Commission and all parties within 30 days of the issuance of this Order. The proposed refund plan shall return the overcollections to customers on a mileage band by mileage band basis in proportion to the rate increases implemented on February 1, 1988.
9. AT&T shall submit a proposed customer notice explaining the rate changes approved paragraphs 2, 3, 4, and 5 to the Commission and all parties within 30 days of the issuance of this order.
10. AT&T shall further adjust its rates to reflect access charge adjustments resulting from the "IntraLata Toll Compensation Case", Docket No. P-999/CI-85-582. AT&T shall submit revised tariffs or price lists reflecting the rate

adjustments to the Commission and all parties within 30 days of their effective date. AT&T shall also file financial schedules and information supporting the proposed rate changes. AT&T shall also file a proposed customer notice explaining the changes.

11. Any party wishing to comment on the filings from paragraphs 6, 7, 8, or 9 shall submit such comments to the Commission and all parties in writing within 20 days of the submission of the filings.
12. This Order is effective immediately.

BY ORDER OF THE COMMISSION

Mary Ellen Hennen
Executive Secretary

(S E A L)